Retirement Reforms Summary Effective March 2016

External Document

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1. Introduction

The Taxation Laws Amendment Act was promulgated on 12 December 2013. This amended the way in which retirement funds are treated. Although these changes were going to be effective from March 2015, the date was postponed to March 2016 (with a possible further postponement to March 2017). National Treasury confirmed during the first week of December 2015 that the retirement reform changes are indeed going ahead as from March 2016.

The amendments will standardise the tax treatment of contributions to retirement funds for the employer and the individual, as well as aligning provident funds to pension and retirement annuity funds. This is to prevent retirees from spending all their retirement assets too quickly.

Employer contributions towards a retirement fund will be taxable as a fringe benefit in the hands of the employee. The sum of the employee contributions and the fringe benefit will be deductible in the hands of the individual employee, limited to 27.5% of the remuneration (taxable income on assessment) or up to the monetary cap of R350 000, whichever is the lowest.

2. Pay-out on retirement

Currently, if you contribute towards a pension fund or retirement annuity, two thirds may be paid out as an annuity (meaning an amount will be paid out on a monthly basis) and one third may be paid out as a lump sum cash amount on retirement. However, if you contribute towards a provident fund, the full amount may be paid out as a cash lump sum on retirement.

There is no change to pension funds and retirement annuities, however, from March 2016, provident fund members will only be permitted to receive one third as cash and the remaining two thirds will be annuitised.

Pension Fund and Retirement Annuity		Provident Fund	
Before March 2016	From March 2016	Before March 2016	From March 2016
One third received as lump sum and two thirds received as annuity.	One third received as lump sum and two thirds received as annuity, therefore, no change.	Lump sum payment on retirement.	One third received as lump sum on retirement and two thirds as an annuity.

2.1 Exceptions

2.1.1 Individuals 55 or older on 1 March 2016

This will only be applicable to individuals who are younger than 55 on 1 March 2016. Individuals who are 55 or older on 1 March 2016 will still be able to take the full amount as a cash lump sum if they contributed towards a provident fund.

2.1.2 Contributions from March 2016

Contributions made up until 29 February 2016 will be unaffected by the new rules. In other words, if an individual contributed towards a provident fund, the contributions made up to 29 February 2016 can be taken as a cash lump sum, but contributions made from 1 March 2016 will be restricted to one third cash lump sum pay-out and two thirds will be paid as an annuity.

2.1.3 *De minimus* rule

As mentioned above, the new rules will apply to contributions towards a provident fund from 1 March 2016, however, the fund members will not be asked to annuitise if the total of those accumulated savings are R247 500 or less ("*de minimus* rule") when they reach retirement. Please note that the amount of R247 500 is proposed by National Treasury but is not yet promulgated.

2.1.4 Resignation from employment

Members will still be able to take all their retirement savings as a cash lump sum on resignation, although pre-withdrawal is discouraged by government. Pre-retirement withdrawal results in high tax implications.

Please take note that the compulsory annuitisation element of the Taxation Laws Amendment Act 2015 (and 2013 and 2014), which affect members of a provident fund, will be postponed for 2 years according to a media statement of National Treasury on 18 February 2016. However, **all the changes to payroll as explained below will still go ahead as previously communicated.**

3. Payroll

3.1 The employer contribution

If the employer contributes towards a retirement fund on behalf of the employee, it will generate a fringe benefit which will increase the taxable remuneration. The fringe benefit is deemed to be an employee contribution.

3.2 Tax deduction

The employee contribution plus the deemed employee contribution (fringe benefit value) is tax deductible. There is, however, an annual limit that must be applied to determine the maximum tax deduction of the total employee contributions towards retirement funds. The limit is the **lowest** of

- R350 000 per annum **or**
- 27.5% of remuneration (excluding severance benefits and fund lump sums)

In the case where the employee has contributed towards a retirement annuity and provided proof to the employer (private retirement annuity), the employer **may** give the benefit to the employee, at the discretion of the employer.

<table>
<tr><th>Deduction limits</th><th>Up to 29 February 2016</th><th>From 1 March 2016</th></tr>
<tr><td>Pension</td><td>Greater of
• R1 750 pa or
• 7.5% of RFI (retirement funding income)</td><td rowspan="5">One limit applies to all funds. The lesser of
• 27.5% of remuneration
• R350 000 pa</td></tr>
<tr><td>Arrears pension</td><td>R1 800 pa</td></tr>
<tr><td>Provident</td><td>Not deductible</td></tr>
<tr><td>Retirement annuity</td><td>Greater of
• R1 750 pa or
• 15% of non-RFI (non-retirement funding income)
• R3 500 less pension deduction</td></tr>
<tr><td>Arrears retirement annuity</td><td>R1 800 pa</td></tr>
</table>

3.3 Fringe benefit calculation

The employer contribution towards the retirement fund, will be a fringe benefit in the hands of the employee. The fringe benefit will be deemed to be paid by the employee for income tax purposes.

The fringe benefit calculation depends on the type of retirement fund. Depending on whether the fund is a 'defined benefit', 'defined contribution' or 'hybrid' fund, the fringe benefit value will be calculated accordingly.

3.3.1 Defined contribution fund

A defined contribution fund (a fund that consists solely of defined contribution components) is a fund for which the contribution can be directly linked to the benefit that the member is entitled to.

The fringe benefit value will be the actual company contribution towards the fund. The employer contributes R500, then the fringe benefit value is R500.

3.3.2 Defined benefit fund

For a defined benefit fund, the value is harder to calculate due to an inherent element of cross-subsidiation across members where the value of contributions does not match the member's benefits.

If the fund is a 'defined benefit fund' then the fringe benefit will be calculated with a formula (the formula will calculate the monthly fringe benefit). The formula calculates a 'notional' employer contribution to the defined benefit fund based on the estimated increase in retirement benefits. The 'notional amount' is the fringe benefit value to the employee.

The fringe benefit value is calculated using the following formula:

X = (A X B) – C

Value	Meaning
X	Represents the fringe benefit amount to be determined.
A	Represents the fund member **category factor** in respect of each employee. It is possible for a fund to have numerous fund member categories and therefore have numerous fund member category factors. The factor will be the same for a group of people contributing the same and receiving the same benefits. For example: the senior management (fund member category A) could have a factor of 0.2358 and the rest of the employees (fund member category B) could have a factor of 0.5254.
B	Represents the retirement-funding income of the employee (see 3.4).
C	Represents the sum of the amounts contributed **by the employee** to the **specific fund** in terms of the rules of the fund in respect of the year of

assessment.

This will only include the **actual employee contribution** and not the deemed employee contribution.

The additional voluntary contributions made by the employee or “buyback” to purchase additional years of service is not included in the value of ‘C’.

3.3.3 Hybrid fund

It is possible to have a fund which has different components (defined benefit, defined contribution, underpin and/or risk components). If this is the case, the fund will calculate a fund member category factor which takes all the components into account. This factor will be applied to calculate the monthly fringe benefit.

3.4 Retirement funding income

From March 2016, retirement funding income will be used in the formula to calculate the fringe benefit for a fund other than a defined contribution fund. Retirement funding income will not be used to calculate the tax deduction limit anymore.

The definition of ‘RFI’ has changed effective March 2016. It is the remuneration (taxable earnings + taxable perks + taxable company contributions) on which the **employer** contribution towards the pension/provident fund is based on. In other words, it now includes only the taxable value of a travel allowance (80%/20% or 100% and not automatically 100% of a travel allowance) and the taxable value of a public office allowance (50% and not the full allowance).

Example: Pension fund is calculated on the basic salary and the travel allowance.

Total earnings of employee		RFI	Reason for exclusion from RFI
Salary	20 000	20 000	
Travel 80%	2 000	1 600	
Bonus	50 000		Pension not based on this component
Total	72 000	21 600	

3.5 No fringe benefit value

There will be no fringe benefit if the employer contributes towards a retirement fund on behalf of an

- employee who retired from the fund or
- in respect of dependants or nominees of a deceased member of the fund.

3.6 Unapproved funds

The tax treatment of unapproved funds stay unaffected. If the employer contributes on behalf of the employee, it will be taxed as a fringe benefit in the hands of the employee. There will be no tax deduction in the hands of the employee.

4. Summaries

4.1 Effect on payroll

CC

- Employer contribution generates a fringe benefit except if the employee is retired from the fund.

FB

- The fringe benefit calculation depends on whether it is a defined contribution fund (DC), defined benefit fund (DB) or hybrid fund
  - DC- fringe benefit is the actual company contribution
  - DB or Hybrid - fringe benefit should be calculated using a formula

EC

- The fringe benefit is a deemed employee contribution
- Total employee contribution = actual deduction plus deemed employee contribution

Limit

- The total employee contributions are allowed as a tax deductible deduction limited to the **lesser** of
  - R350 000 per annum or
  - 27.5% of remuneration (subject to certain exclusions)

4.2 Summary of tax treatment of defined contribution fund

	Not retired from fund	Retired from fund
Company contribution	R1000	R1000
Fringe benefit	R1000	R0
Deduction	R1000	N/A
Tax deductible deduction	R2000 (employee deduction plus deemed deduction)	R0 (if the retired employee still contributes, then the deduction will be allowed)
Limit	Lesser of R350 000 pa or 27.5% of fund remuneration	Lesser of R350 000 pa or 27.5% of fund remuneration

4.3 Summary of tax treatment of a defined benefit or hybrid fund

	Not retired from fund	Retired from fund
Company contribution	R1000	R1000
Fringe benefit	Calculated according to the formula	R0
Deduction	R1000	N/A
Tax deductible deduction	R1000 plus the value calculated as the fringe benefit (employee deduction plus deemed deduction)	R0 (if the retired employee still contributes, then the deduction will be allowed)
Limit	Lesser of R350 000 pa or 27.5% of fund remuneration	Lesser of R350 000 pa or 27.5% of fund remuneration

5. Preparation required from employer

5.1 Confirm type of fund

Confirm with your fund whether the fund is a defined contribution (DC), defined benefit (DB) or hybrid fund.

5.2 Obtain the contribution certificate from your fund

If you are affiliated with a defined benefit or hybrid fund, the fund will provide the employer with a contribution certificate in respect of each fund member category. This certificate will indicate the components of the fund, name of the fund, category factor etc.

5.3 Category factor

If the fund is a defined benefit or hybrid fund, the category factor is necessary to calculate the fringe benefit correctly. This should be obtained from the fund and entered into the applicable field on the payroll system.

5.4 Discuss with employees

Employees need to know how and if they will be affected by the new rules. Discuss this with employees so that they will be prepared.

5.5 Release notes

Familiarise yourself with the release notes of the specific SAGE HR and Payroll product which you are using to ensure that you make the necessary changes, as some user input will be necessary.

Contribution certificates must be obtained from the fund. The above information cannot be provided by the support desk.

6. IRP5 codes

IRP5 code	Explanation
4472	Employer's **pension fund** contributions
4473	Employer's **provident fund** contributions
4475	Employer's **retirement annuity** fund contributions
3817	Value of taxable benefit i.r.o employer's **pension fund** contributions
3825	Value of taxable benefit i.r.o employer's **provident fund** contributions
3828	Value of taxable benefit i.r.o employer's **retirement annuity** fund contributions
4001	Total pension fund contributions paid or 'deemed paid' by employee

4003	Total provident fund contributions paid or ‘deemed paid’ by employee
4006	Total retirement annuity fund contributions paid or ‘deemed paid’ by employee.
3697 **3698** **4002** **4007**	RFI Non-RFI Arrears Pension Arrears RA — N/a from March 2016

7. Sources

Taxation Laws Amendment Act, 2013

National Treasury: Questions and Answers 3rd December 2015 – Tax harmonisation and retirement reforms

SARS notice to employers – September 2015 PAYE reconciliation clarification

Regulation ito Par 10D(5)(b) of Seventh Schedule to the Income Tax Act on information to be contained in contribution certificate (GG 39538, 18 December).

SARS Business Requirement Specification, V15

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